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UNCLAS SECTION 01 OF 08 NEW DELHI 001432

C O R R E C T E D COPY (CHANGES IN TEXT, PARA 15 AND 16)

SENSITIVE
SIPDIS

FOR SENATOR FEINGOLD FROM AMBASSADOR MULFORD; STATE FOR
SCA/INS, H

E.O. 12958: N/A

TAGS: [PREL](#) [PGOV](#) [ECON](#) [KNNP](#) [IN](#)

SUBJECT: SCENESETTER FOR SENATOR FEINGOLD'S MAY 2008 VISIT
TO INDIA

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1. (SBU) Dear Senator Feingold: The Country Team and I warmly welcome you to India. Your visit comes at a critical juncture in what has been a period of profound transformation in Indo-US relations. While we have successfully accelerated and expanded the ties between our two democracies into a broad, comprehensive relationship, the ruling coalition, known as the United Progressive Alliance (UPA), has effectively stalled the implementation of the civil nuclear initiative in the face of vociferous Communist opposition, which has threatened to bring down the government if India gets closer to the U.S. Despite the delay in implementing the initiative, which has impacted other potential collaborative activities, the long term prospects for a closer, abiding bilateral relationship with a vibrant, prosperous India are very strong - and remain of strategic importance to the U.S. With India set to surpass China as the fastest growing economy in 2015, this may well become our most important bilateral relationship within 20 years. Your visit helps demonstrate the vitality and breadth of our relationship, which now touches on almost all areas of human endeavor. Our Embassy is trying to put out the public message that there are numerous natural complementarities and deep linkages between our two countries. We hope that the more these linkages bring visible benefits to ordinary Indians, the more the Communist party's intransigence and ideology will be seen as incurring heavy costs to India and its people. The bright spot remains the private sector's exponential growth and people-to-people ties, to which government-to-government ties ultimately must catch up.

2. (SBU) This message provides you an update on the status of the civil nuclear deal, political climate, economic situation, trafficking in persons and climate change.

The Civil Nuclear Cooperation Initiative

3. (SBU) President Bush and Prime Minister Singh pledged in July 2005 to take a series of reciprocal steps that would culminate in the opening of India's formerly sanctioned civil nuclear market. India completed the first milestone on March 2, 2006 by releasing a plan to separate its civilian and strategic nuclear programs in a phased manner, and pledging to place its civilian facilities under International Atomic Energy Agency (IAEA) safeguards. An overwhelming, bipartisan majority in the U.S. Congress then approved in December 2006 the Hyde Act, which allowed the U.S. and India to engage in

civil nuclear trade. The U.S. and India concluded an Agreement for Peaceful Nuclear Cooperation, also known as the 123 Agreement, in July 2007, which sparked political turmoil when the Communist parties threatened to withdraw their support from the government because the Agreement, they felt, brought India too close to the U.S. The opposition parties also claimed that the terms of the Hyde Act and 123 Agreement rendered India's nuclear weapons program useless. Meanwhile, India and the IAEA have effectively reached agreement on a safeguards agreement. The coalition United Progressive Alliance (UPA) government has had several meetings with the Left opposition to convince them of the merits of the initiative, but the postponement of a meeting originally scheduled on May 28 indicates that Left intransigence remains strong. Should the government receive the go-ahead, it will submit the agreement to the IAEA Board of Governors for approval, and the U.S. will seek to enact a policy change in the Nuclear Suppliers Group (NSG) to allow India to engage in civil nuclear commerce globally. Finally, the Administration will submit the 123 Agreement to the U.S. Congress for an up-or-down vote of approval. Civil nuclear cooperation between the U.S. and India will offer benefits to both countries' citizens through enhanced energy security, more robust nonproliferation efforts, an energy source without carbon emissions, and greater economic opportunities.

The Political Landscape

14. (SBU) Indian domestic politics is practiced within a vibrant, raucous, few-holds-barred democratic environment. Indians take their democracy seriously and vote in large numbers, with turnout sometimes exceeding 75 percent. The election campaign never ends because an election of significance is always around the corner somewhere in the country. In addition to national elections which are due

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every five years (but can and often do occur more frequently), several states go to the polls each year for elections to the state legislatures. Two national parties are perched at the top of the political pyramid -- the left-of-center Congress Party and the right-of-center Bharatiya Janata Party (BJP). Below them are dozens of smaller regional, state and special-interest parties. While both the Congress Party and the BJP battle across all the disparate regions of the country, neither has the ability to form a government in Delhi on its own and must rely on fractious and unwieldy coalitions with smaller regional parties to govern.

15. (SBU) The once mighty Congress Party, dominated for long by the Nehru-Gandhi dynasty and in the forefront of the independence movement, has lost its aura and fallen in stature. It ruled India for most of the period since Independence in 1947 but its credibility has eroded over the years because of the autocratic ways of its leaders, its failure to respond to regional aspirations, and its inability to adapt to the changing India. The BJP, with its roots in a muscular Hindu response to centuries of foreign subjugation, first by a succession of Muslim rulers from Central Asia and then by the British Empire, has emerged as a viable alternative to the Congress Party. It occasionally reverts to its Hindu nationalist rhetoric but has tempered its discourse and broadened its appeal to position itself as a mainstream political force. It led the National Democratic Alliance (NDA) coalition government from 1999-2004 before being unceremoniously ousted by the voters for its failure to more evenly disperse the benefits of a "Shining India" to the 65 percent of the population that lives in rural India.

16. (SBU) The Congress Party, which leads the current United Progressive Alliance (UPA) coalition government, staggers into its final year in office bruised and battered by a series of setbacks in state elections during the last year

and a bitter squabble between UPA coalition allies over the U.S.-India civil nuclear agreement. Public bullying by its communist party allies has fueled perceptions of a feeble and indecisive party with no back-bone, intent on hangng on to power even at the cost of compromising on its principles. The BJP, in contrast, has the wind in its sails after its thumping wins in state elections last year and this year in the large southern state of Karnataka. Sensing blood, the party set aside years of internal struggles following its 2004 loss to unite under the leadership of former Party President and former Deputy Prime Minister L.K. Advani. It has consolidated its support with its NDA allies. It has taken lessons from its recent state election wins to sharpen its strategy and hone its message for the coming national elections.

¶7. (SBU) In search of a make-over, the Congress Party unveiled a "please-all" super-populist budget in February, opening up the public purse strings in typical Indian election year style. While the budget's centerpiece is a USD 17 billion write-off of farming debt (to be financed over four budgets), it also includes sops for almost every interest group and voter block. The Congress Party's hope that this election year largesse would revive its waning fortunes failed as the party suffered another humiliating state election loss to the BJP in May in the bellwether southern state of Karnataka. Some observers believe that the Indian voter is too sophisticated to be taken in by such cynical election year pandering by the Congress Party. In any event, it is impossible to predict at this time which party will emerge on top in the national elections. But, it is safe to say that that neither the reeling Congress Party nor the surging BJP is likely to win a majority on its own and either will have to forge a coalition with the smaller regional parties to form a government. The smaller parties will continue, therefore, to exert greater influence on government policy that their numbers in Parliament would justify.

A COMPREHENSIVE ECONOMIC RELATIONSHIP

¶8. (SBU) The bilateral economic relationship is a critical driver in deepening ties between our countries. This is happening through government exchanges such as the Economic Dialogue and the Trade Policy Forum, and by our countries' private sectors, including the CEO Forum, that are boosting

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U.S.-India trade and investment to new heights.

INDIA'S ECONOMIC TRAJECTORY - ONE OF TRANSFORMATION

¶9. (SBU) I know that you are well aware of India's economic performance that has seen Gross Domestic Product (GDP) growth jump in the last two decades from the 6 percent range to nearly four years straight of 8.5 percent compounded annual growth. While there is some question whether this is simply cyclical, we perceive fundamental structural changes underway that are reshaping India's socio-economic landscape. These include the significant rise in savings and investment, the declining share of agriculture in GDP, replaced by industry, and the "market-seeking" flows of foreign direct and portfolio investment into the country. Since two-thirds of India's economy is driven by domestic consumption, we anticipate a U.S. economic slowdown will initially take off only about half a percent of GDP, with growth remaining around 8%. If financial markets deteriorate sharply in line with continuing U.S. market declining growth, India may be impacted more severely.

¶10. (SBU) Savings have risen over the past decade to hit roughly 33 percent of GDP, a combination of more corporate

saving and less government dissaving (debt financing). While corporate savings may ebb a bit in the next decade, household savings are also beginning to rise and to become more fluid, moving from government subsidized post office savings deposits to commercial banks and mutual funds. Investment has also grown significantly in recent years, nearing 37 percent of GDP - again, mainly a function of corporate expansion plans, but the government's infrastructure goals are boosting public investment levels as well. Indian economists have noted that many Asian economies hit a "take off" stage in their growth once investment crossed the threshold of 40 percent of GDP. The savings-investment gap is clearly financed through imports and a trade deficit, but other inflows, including the FDI and portfolio investment noted above, have kept the balance of payments in surplus for three years, and foreign exchange reserves continue to rise, already surpassing USD300 billion, one of the largest in the world.

¶11. (SBU) The agricultural sector is critical to many households' incomes, since more than 50 percent of India's workers are involved in agriculture. But in terms of GDP, agriculture accounts for less each year, last year contributing just 18 percent to national economic growth. On a macro scale, this decline lessens the volatility of growth that India's mainly monsoon-dependent agricultural sector brought, further making sustained GDP growth in the 8-9 percent range a likely scenario. Politically, however, the government struggles with proposed reforms that would have a broad effect on the 600 million people who are dependent on this under performing sector. In India, the rural poor vote much more than the urban masses, so any dislocation in the agricultural sector has the potential to have wide-ranging political consequences.

¶12. (SBU) At the same time, India's manufacturing sector is finally showing signs of expansion and global attention. Stuck at roughly 14 percent of GDP for nearly two decades - a stark contrast to many Asian economies' growth trends - manufacturing grew to 17 percent of GDP last year, and with recent double digit growth, appears likely to continue its increasing contribution to GDP.

JUST TWO INDIAS?

¶13. (SBU) India clearly has stark differences in rural/urban ratios in social and economic indicators, and at just 30 percent urbanization, one of the lowest urbanization rates in the world. The urban poor are the fastest growing segment of the population, at roughly five per cent per year. In India's "mega cities", those with a population greater than one million, 40-60% of the inhabitants live in slums or other informal settlements. Since much of the visible economic boom this past decade has been in knowledge-intensive industries, mainly in urban areas, there is a widely held perception of two widely different and diverging Indias in urban and rural India. However, recent studies suggest that

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surprising developments are quietly underway outside India's cities. One of the most important is that agriculture now accounts for only half of India's rural economy; no longer is rural synonymous with agricultural. Also critical for understanding India's transformation is that rural incomes have been growing faster than urban incomes in recent years.

¶14. (SBU) Changes are underway in India's villages and small towns, but definitions and methodologies of measuring these changes are lagging. The non-agricultural rural economy that is seeing incomes rise includes the increasing use of casual or contract labor, outside factories, for apparel assembly; the rise in national markets for traditional handicrafts; the rise in tourism, especially domestic; emerging agro-processing industries; sale of land for industrial use;

and creation of linkages for goods and services between major metros' demand and rural areas' supply. These dynamics are likely to become clearer in the next few years, as domestic companies, especially in retail, have begun to turn their marketing focus to India's rural sector, as urban markets become saturated. This "bottom of the pyramid" approach is the best indicator of how employment, income, and consumption tastes are changing outside of India's metros.

¶15. (SBU) However, poverty remains a considerable and sober challenge in India, with official (consumption-based) estimates placing about 26 percent of the population below the poverty line, which many consider an underestimation. International standards put about 35% of the population below the poverty line, meaning they live on under one dollar a day. In spite of India's economic growth over the past decade, 47% of its children are malnourished, 2.4 million children die each year of preventable diseases (and 500,000 of those from diarrhea), only 38% of the children are fully immunized, and 50% of children drop out of school before the eighth grade. In considering India's growth story and its need for inclusive growth, it is probably more useful to think of regional and state differences that create more than just the two India's of its cities and countryside. Food inflation is a matter of serious concern to the government as it affects the livelihood of the aam aadmi (common man) in India and, hence, is highly politically sensitive, especially in a pre-election year. Prices of essential food items, such as vegetable oils, pulses, and, more recently, rice, have risen sharply. Nevertheless, domestic Indian prices of wheat, rice, corn and sugar are still among the lowest in the world. In a knee-jerk reaction to the rising food price inflation, the Government of India has announced a number of measures in 2007-2008 to contain the price rise of essential food items, including export bans on rice and wheat.

BIG SHIFTS POSE CURRENT CHALLENGES

¶16. (SBU) As manufacturing and industrialization take off, businesses need land, as seen in the attempt to establish special economic zones across the country. Most States are developing their own policies for land acquisition or leasing, but are looking to the central government to articulate a resettlement policy for those who are displaced by transitioning land from agricultural to industrial use. This is a challenge given India's land size is only one-third China's, yet supports nearly as many people. For Indian landowners themselves, the transition is less problematic, as land prices have gone up considerably. However, landless agricultural workers and those who leased their land from bigger farmers do not receive any compensation for the loss of their livelihood when land is purchased from the farmers. Before these changes, they were already among the most economically vulnerable.

¶17. (SBU) India's emerging organized retail sector, especially in produce, poses another challenge to the current socio-economic structure. Currently, only 3 percent of the food retail sector is organized. Many states still have laws that limit the sale of produce to state-sanctioned markets. Thus, direct sale to private buyers was prohibited. While the ostensible reason was to protect the farmer (through state supervision), the result has been a sanctioned monopoly that created middlemen - called commission agents - who often exploited the farmers' lack of selling options. The result is that Indian farmers typically get 35 percent of the final retail price of their goods, while in countries with more organized retail, farmers get 65 percent of that final price.

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¶18. (SBU) Organized retail would benefit farmers and consumers, but make uncertain the fate of small street vendors and shopkeepers, who number as many as 40 million.

These groups have joined together in several politically active associations to protest - and slow down or stop - the development of organized retail. While Wal-Mart figures into the rhetoric because of its backend supply joint venture with Bharti Enterprises, much of the focus is on several large Indian companies, including Reliance. The benefits to farmers, from higher sale prices, extension services that retail companies have offered, and improved infrastructure and supply chains, would be revolutionary.

BILATERAL TRADE GROWING

¶19. (SBU) India-U.S. two-way merchandise trade touched USD42 billion in 2007. Last year, the U.S. trade deficit with India went down 42 percent. Despite this strong growth in the trade relationship, a number of impediments persist and could impact future trade in both directions. U.S. exporters continue to encounter tariff and non-tariff barriers, despite Indian economic reforms and autonomous (non-WTO) reductions in duties applied to industrial goods.

¶20. (SBU) Both countries have sought to advance our bilateral trade dialogue through the U.S.-India Trade Policy Forum, which is chaired by USTR and the Commerce Ministry and meets semiannually. The five focus groups that comprise the Forum- agriculture, intellectual property, investment, services, and tariff and non-tariff barriers- interact regularly, often through video conferences

¶21. (SBU) Included among the bilateral Trade Policy Forum issues are a number of food and feed market access concerns. For example, the USG has been pressing the Indian government to allow in U.S. poultry, pet food, dairy products and wheat for some time now. But the Indian government has not only refused to accept the safety of these products or recognize our regulatory systems and standards, they have thrown up additional requirements not based on science. In fact, the U.S. maintains a 3:1 trade deficit with India on food and agricultural products with Indian food/feed shipments to the U.S. of USD1.4 billion. Further, the Indian government has requested the U.S. allow in imports of Indian fruit such as grapes, pomegranates and mangoes. However, only mangoes have been permitted to enter the U.S. - using radiation treatment to mitigate pests - due to the GOI's inability to certify that pest mitigation controls are in place in shipments to the United States.

ECONOMIC POLICY-MAKING IN A COALITION

¶22. (SBU) After delivering several key reforms, including a national value-added tax, Open Skies Agreement with the U.S. (India's first), improved patent protection through legislation, and privatization of major airports, reform momentum has noticeably stalled in the UPA coalition. Several key legislative amendments to liberalize the banking, insurance and pension sectors are stuck in Parliament, mainly because of opposition by the Left parties. The Finance Minister has acknowledged this, ascribing it to the challenge of heading a coalition. Given the UPA's inherent instability, and the harsh ideological divides between the Left and reformers like the Prime Minister and his economic team, the Ministry of Finance (MoF) has publicly described a newer approach to "opportunistic reform" - exploiting new economic developments or pressures that permit non-Parliamentary reforms to be enacted.

NEW BUDGET HAS PRE-ELECTION POPULIST FOCUS

¶23. (SBU) The UPA presented its last budget before national elections on February 29 and delivered an expected pre-election, populist budget that targeted both poor farmers and middle class taxpayers. While government finances can

handle some increased spending - revenues have more than doubled since 2002 - the \$189 billion budget broke with the past few years of fiscal debt reduction. It promises a \$15

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billion small farmer debt waiver, to be financed over four budgets, and no reform of ballooning, but ineffective, subsidies for food, fertilizer, and oil. The budget did increase allocations for education and health by 20% and 15% respectively, as the government seeks to boost access to primary health care and secondary education, especially in rural areas. The government also significantly raised spending on urban and rural infrastructure, including roads, electrification, and sanitation.

MILITARY TO MILITARY

124. (SBU) The trend in the U.S.-India security relationship is overwhelmingly positive, despite irritants such as unsigned agreements on logistics support and the sharing of classified information, which have lingered for years. The Indian military - particularly the Navy - generally is more willing to push the envelope on closer relations than any other GOI body. Malabar 2007 brought Japan, Australia and Singapore together with the U.S. and India for the first time for naval exercises. Red Flag 2008 in the Nevada desert will include India as the first-ever non-NATO country/major non-NATO ally to participate. The first ever U.S.-India cooperation under the Global Peacekeeping Operations Initiative took place in January 2008, and with India as a global leader in PKO participation and training, there is hope for expanding GPOI cooperation. Secretary Gates visited India February 26-27, the first visit by the U.S. Secretary of Defense since Secretary Rumsfeld signed the Defense Framework Agreement in June 2005, and solidified gains in military-to-military relations. Defense sales, dormant for over 40 years while India was essentially a Soviet client, have just started to take off, with a billion dollar deal for six C-130s finalized in January the latest breakthrough. We're hoping to finalize a separate billion dollar deal for P-8 maritime patrol aircraft, and both Boeing and Lockheed Martin are competitors for the estimated \$10 billion combat aircraft bid expected to be decided in 2009.

TERRORISM/COUNTERTERRORISM

125. (SBU) India continues to rank among the world's most terror-afflicted countries. The conflict in Jammu and Kashmir, attacks by extreme leftist Naxalites and Maoists in eastern and central India, assaults by ethno-linguistic nationalists in the northeastern states, and terrorist strikes nationwide by Islamic extremists took more than 2,300 lives in 2007. There were several major attacks linked to Islamic extremists in 2007, including an attack this month in Jaipur which killed more than 60 Indian citizens. Indian officials claim that the perpetrators of these attacks have links to groups based in Pakistan and Bangladesh, particularly Lashkar-e-Taiba, Jaish-e-Mohammad, and Harkat-ul-Jihad Islami, among others. The violence in Jammu and Kashmir abated somewhat in 2007, but the area remains volatile. Prime Minister Singh has called leftist extremist (Maoist or agrarian Naxalite) groups, "the greatest threat to India's internal stability and democratic culture." Leftist extremist groups are very active in wide areas of impoverished rural eastern and central India, and also operate in parts of southern India. Ethnic-linguistic separatist groups attack and kill in Northeastern India, particularly in the states of Assam, Nagaland, Manipur, Tripura, and Meghalaya. Several proscribed terrorist groups operate in the northeast, including the United Liberation Front of Assam (ULFA) and the People's Liberation Army.

¶26. (SBU) The lack of security, remoteness, and inhospitable terrain combine to prevent the government from providing security and other basic services in many of the areas in which the leftist extremists and the northeastern separatist groups operate. The Indian government's counterterrorism efforts are hampered by its outdated and overburdened law enforcement and legal systems. The Indian court system is slow, laborious, and prone to corruption; terrorism trials can take years to complete. Many of India's local police forces are poorly staffed, lack training, and are ill-equipped to combat terrorism effectively.

¶27. (SBU) The United States cooperates with India under the Counter Terrorism Joint Working Group, which meets twice a

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year. Our Anti-Terrorism Assistance program provides training to India's law enforcement officials. One area of concern is that the program will be cut significantly in FY ¶2009. We are also in the beginning stages of developing regional programs designed to bring together relevant officials from South Asian nations in training opportunities. The Office of Defense Cooperation also provides counterterrorism courses to a small number of military and civilian officials each year.

TRAFFICKING IN PERSONS

¶28. (SBU) The Department of State is required by law to submit a report each year to the U.S. Congress on foreign governments' efforts to eliminate severe forms of trafficking in persons. The report is intended to raise global awareness, highlight efforts of the international community, and encourage foreign governments to take effective actions to counter all forms of trafficking in persons. Countries meeting minimum standards under U.S. law are placed in Tier ¶1. Those assessed as not fully complying with minimum standards but which are making significant efforts to do so are classified as Tier 2. Countries assessed as neither complying with the minimum standards nor making significant efforts to meet them are classified as Tier 3.

¶29. (SBU) To quote the 2007 Trafficking in Persons (TIP) Report: "India is placed on the Tier 2 Watch List for a fourth consecutive year for its failure to show increasing efforts to tackle India's large and multidimensional problem. Overall, the lack of any significant federal government action to address bonded labor, the reported complicity of law enforcement officials in trafficking and related criminal activity, and the critical need for an effective national-level law enforcement authority impede India's ability to effectively combat its trafficking in persons problem."

CLIMATE CHANGE

¶30. (SBU) As a non-Annex I country with no obligations beyond monitoring and reporting emissions, India is a strong supporter of the Kyoto Protocol and is fully locked into the UN Framework Convention on Climate Change (UNFCCC). While India is a regular participant in the Major Economies Meetings (MEM) process and takes the threat of climate change seriously, the GOI position on climate change has remained virtually unchanged and can be summarized in the following four points: 1) any future international agreement on climate change must be negotiated under the rubric of the UNFCCC; 2) the common but differentiated response language of the UNFCCC must be maintained; 3) India's economic development and poverty alleviation goals require great increases in power generating capacity which is highly dependent on coal and any accompanying increases in India's green house gas (GHG) emissions cannot be reduced or checked

by a future agreement on climate change; and 4) clean technology transfer must be provided to India and other developing countries at low or no cost. Recently, Prime Minister Manmohan Singh announced India would never emit more GHGs on a per capita basis than the average emissions of developed countries. Given India's population of approximately 1.2 billion, this pledge will have no impact on curbing India's GHG emissions for the foreseeable future considering that, on a per capita basis, India is ranked 146 in GHG emissions despite the fact its gross emissions overtook Russia's in 2007, making India the world's fourth largest overall emitter of GHGs. It should be noted, however, that large scale development of civilian nuclear energy, as permitted under the U.S.-India civil nuclear agreement, would substantially reduce India's future production of greenhouse gases.

VISA GROWTH MIRRORS PEOPLE-TO-PEOPLE TIES

131. (U) One of the fundamental strengths of the U.S./India relationship is large number of Indians who have personal links to the United States. Following decades of travel and immigration (even through the darkest days of our bilateral

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relationship) a majority of the people you would meet in a Board Room or at a Government conference table have some family who have studied, worked, or lived in the United States. With some 84,000 enrolled in the United States, India is the largest source country for foreign students. This remarkable trend is accelerating, as visa demand is increasing by 25% per year (50% in Mumbai). Mission India, understanding the underlying value of the mutual understanding gained through increased travel, has dedicated unprecedented resources to the challenge. As a result in FY 2007, our non-immigrant visa production soared from 459,000 to 726,000 cases. We are investing in infrastructure and personnel to continue to make people-to-people ties one of the pillars of our dynamic bilateral relationship. Finally, another interesting trend is the increase in Indian-Americans who are returning to their country of birth to take advantage of the economic miracle here.

132. (SBU) Once again, we look forward to welcoming you to India and to working with your staff to ensure a successful and productive visit.
MULFORD